Funding the Future

Need I say more: the House of Lords say the Big 4 are a...

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A report by the House of Lords Economic Affairs Committee published today (Wednesday 30 March) has called for a competition probe into the Big Four auditors' oligopoly. Their â€šÃ„Ã²complacency' and â€šÃ„Ã²dereliction of duty' contributed to financial crisis, the report found.

* Economic Affairs Committee Second Report — Auditors: Market concentration and their role

The House of Lords Economic Affairs Committee's report follows an eight month investigation into the audit market. There are three main areas of findings.

â€šÃ„Ã²The Big Four auditors' domination of the large firm audit market limits competition and choice'

In 2010 they audited 99 of the FTSE 100 largest listed companies, which change auditors every 48 years on average. In bank audit in the UK only three of the Big Four are active. And there is the risk that one of the Big Four might leave the audit market, leading to an unacceptable degree of market concentration.

The Committee calls on the Office of Fair Trading to hold a detailed investigation into the audit market with a view to a possible inquiry by the Competition Commission. It recognises that the global reach of the Big Four audit firms — Deloitte, Ernst & Young, KPMG and PricewaterhouseCoopers — goes beyond the scope of national authorities, but considers that the UK should take a lead since London is a major global financial centre where the Big Four are particularly prominent.

â€šÃ„Ã²The breakdown of dialogue between bank auditors and regulators made the financial crisis worse'

Auditors were either unaware of the mounting dangers in the banks or, if they were aware, failed to alert the supervisory authority. The paucity of meetings between bank auditors and the supervisor was a “dereliction of duty” by both auditors and regulators. The Committee recommends legislation to re-establish mandatory two-way confidential dialogue between bank auditors and supervisors to help avoid a similar crisis in future.

â€šÃ„Ã²Audit standards are slipping’

The Committee heard that International Financial Reporting Standards (IFRS), which became mandatory for EU listed companies in 2005 and are intended to pave the way towards common accounting standards around the world, had lowered audit standards. They encouraged box-ticking and reduced scope for auditors to exercise judgement to reach a true and fair view. The Committee recommends that prudence be reasserted as the guiding principle of audit.

Committee Chairman, Lord MacGregor of Pulham Market, said:

â€šÃ„Ã²Our inquiry has revealed widespread concerns about the Big Four’s dominance and the risk that they could become the Big Three. Our report makes several recommendations to reduce this dominance but we feel that this market concentration is of such significance that a thorough review of the issues by the Office of Fair Trading and possibly the Competition Commission is now overdue. Equally important is our support for regular meetings between auditors of financial institutions and regulators to avoid the serious failures of communications between the two which were so starkly revealed by the evidence to us and which contributed to the financial crisis.’